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C O N F I D E N T I A L SECTION 01 OF 02 TAIPEI 000710

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SUBJECT: BUSINESS AND POLITICS BLEND IN TAIWAN UMC CASE

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Classified By: AIT DIRECTOR DOUGLAS H. PAAL, REASON 1.5 B/D

11. (C) Summary: Taiwan government charges that United Microelectroncis Corporation (UMC) violated Taiwan regulations in its relations with China chipmaker He Jian have shaken business and political circles in Taiwan. The ensuing public debate has included allegations of political revenge, deliberate sabotage of talks between President Chen and People's First Party (PFP) Chairman James Soong, shifting signals on cross-Strait trade, and the need to liberalize investment regulations. Taiwan's National Security Council insisted to AIT on February 22 that the case was not about investment regulations at all, but about corporate governance. By all appearances, the crackdown on UMC is another example of the Taiwan uneven mixture of business, government, and politics into disjointed policy. A positive outcome of the case is possible if it can spur liberalization of regulations on investment in China needed to keep Taiwan economically competitive. End summary.

Crackdown on One Company

12. (C) According to media reports, Taiwan's Ministry of Justice Investigation Bureau (MJIB) raided the offices of UMC on February 15 searching for evidence the company had illegal investments or transactions with China-based chipmaker He Jian Technology of Suzhou. Investment in chip production without prior Taiwan government approval would violate Taiwan's regulations. Investment in high-tech, or sensitive technologies in China requires case-specific approval from Taiwan's Investment Commission, under the Ministry of Economic Affairs. Government auditors had also noted the transfer of significant company assets from UMC to He Jian and suspected financial impropriety. The MJIB detained the head of He Jian, Taiwan national and former UMC employee Hsu Chien-hua (he was released on bail on February 17).

Shock in the Business Community

13. (C) The massive raid on UMC, one of Taiwan's leading companies, the world's second largest foundry producer of integrated circuits, listed on the Taiwan and New York (as ADR) stock exchanges, sent shock waves through local business and political circles. The timing of the raid seemed to call into question the Chen administration's promises to expand cross-Strait economic ties. Several business leaders expressed sympathy for the UMC position which they saw as highlighting the need to update and clarify current regulations. Some business leaders noted that Taiwan businesses commonly used various methods to evade restrictions on investment in China and wondered why UMC had been singled-out and if the crackdown would be extended to other companies. Minister of Economic Affairs Ho Mei-yueh tried to calm the unease in the business community by stating on February 17 this was not a change in policy, or an attempt to discourage investment in China, and that all legal investment in China would be protected. Premier Frank Hsieh quickly issued a statement emphasizing that on-going plans to liberalize investment in China would continue.

Speculation of a Political Motive

14. (C) Some media accounts saw it as no coincidence that UMC Chairman Robert Tsao has been an outspoken supporter of opposition PFP Chairman James Soong. The accounts viewed the raid as political revenge, and used the term "green terror" to evoke the image of Pan-green persecution of its political opponents. Media that supported the ruling party speculated the raid may have been a plot by the KMT to sabotage cooperation between ruling party and the PFP. A more sophisticated speculation was that the Chen administration wanted political cover for liberalizing outdated rules. By first highlighting the questionable activities of an opposition-affiliated company, moves to regularize the company's situation would make the administration appear conciliatory towards the opposition (reftel reported a more liberal policy on cross-Strait investment may be in the works). Taiwan Semiconductor Manufacturing Corporation

(TSMC) Chairman Morris Chang has complained loudly to all who will listen about the need for an investment policy that allows Taiwan IC foundries to compete in China with their Chinese rivals, and thereby retain Taiwan's commercial lead.

15. (C) UMC Chairman Robert Tsao responded to the media reports with full-page ads in local financial newspapers on February 18. The ads admitted that UMC helped He Jian establish an eight-inch silicon wafer plant in China and that UMC planned to merge with He Jian in the future, but denied that UMC's assistance to He Jian violated Taiwan regulations on investment in China. The ads claimed that Tsao had established He Jian expressly to compete with China's biggest chipmaker, Semiconductor Manufacturing International Corporation (SMIC, the world's third largest IC producer after TSMC and UMC). In his statement, Tsao claimed his actions were in Taiwan's best economic interests since only through investment in China could Taiwan chipmakers hope to compete successfully with Chinese chipmakers. Although He Jian started silicon wafer production only two years ago and is still small scale, it has announced plans to invest more than USD 10 billion over the next 10 years in a bid to become China's largest silicon chip foundry.

NSC Says It Isn't So

16. (C) Taiwan's National Security Council (NSC) held a ministerial-level meeting on February 22 to discuss the UMC case and cross-Strait economic policies. It was widely reported that the discussions included plans to liberalize cross-Strait investment regulations and a method to regularize UMC's situation. However, an NSC contact somewhat incredibly insisted to AIT that the UMC case was not primarily about cross-Strait investment, but rather about UMC's lack of corporate governance in its transfer of assets including capital, personnel, and patents to another company without the approval of shareholders or the company's board of directors.

17. (C) Comment: UMC is a world-class corporation with an international outlook uncommon among Taiwan corporations. It has met listing requirements on the New York (as ADR) and Taiwan stock exchanges. Premier Frank Hsieh and economic officials have insisted that this is an individual case that will not affect on-going moves to liberalize investments in China. While it is unclear whether it was business or political rivals that first made allegations of UMC impropriety, or whether it was government auditors who uncovered questionable transactions, it is clear the case has released widespread, pent-up criticisms of the current restrictions on investment in China. The case has also given the Chen administration leverage that can be used to pressure the PFP and provide political cover liberalizing investment regulations.

18. (C) Most significantly, the case may spur substantially relaxed restrictions on cross-Strait economic exchanges, possibly including investment in China in small flat panel displays, IC packaging, and naphtha crackers. Taiwan may also relax restrictions on cross-Strait banking. If the government can find a way to regularize UMC's activities in China without harsh punishment, it could portray liberalization as a goodwill gesture to opposition parties. If newly appointed Vice Premier Wu Rong-yi would then endorse the liberalization, his reputation as an outspoken opponent of tech transfer to China would undercut opposition to the move. China is the world's fastest growing semiconductor market and will remain so for the foreseeable future. From a business point of view, it is vital to Taiwan's own semiconductor firms that they participate as fully as possible in China's market. End comment.

PAAL